10/81

Financial Markets

Irving Trust

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Economic Research & Planning Division

Friday
(Noon)

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October 1 seemed to be the start-up date for just about everything--the new Federal fiscal year, the introduction of the "All Savers" certificates, the initial phase of the Administration's tax reductions, the beginning of same-day settlement in the Clearing House Interbank Payments System (CHIPS), and the effective date for the Fed's new rules governing the surcharge on the discount rate. For much of the week, the funds market was under pressure; and by the end of the week, doubts were growing among market participants as to how much of the pressure was due to technical aberrations. Simultaneously, indications of growing economic weakness continued to accumulate--the most graphic being the 0.3% jump of the unemployment rate to 7.5% in September. The result was that short-term rates moved up over the week, while long-term rates declined slightly on balance.

Contributing to the upward pressure on the funds rate was the "window dressing" activity of some banks on Wednesday, as well as the start of same-day settlement in CHIPS on Thursday. A number of banks apparently experienced mild operational difficulties related to funds transfer, and many were being extra cautious in covering their reserves positions. That caution contributed to the tightness and should persist for a few days until the new procedure becomes routine. However, the new CHIPS procedure was likely not the only factor behind the firmness--the Fed's new rules governing the discount rate surcharge should also have made banks bid somewhat more aggressively in the funds market.

The Federal Open Market Committee meets next Tuesday against a background of growing signs of economic weakness. The monetary aggregates continue their schizophrenic behavior, with M-1B well below its target and M-2 slightly above its target. The divergence reflects a complex pattern of shifts of funds into money market mutual fund shares and deposit instruments paying market rates. Though these problems must be extremely frustrating to the Fed, there is as yet no indication that any attempt will be made to move M-1B quickly back to its target.

Indeed, considering that the Fed moved to brake the plummeting funds rate by changing the surcharge rules, one can argue that nothing has been done in recent weeks to ease Fed policy materially. Certainly the reserves data indicate no such move. The Fed may well want to wait a while and assess the near-term behavior of the aggregates a bit more, since expectations are widespread that M-1B will grow strongly in early October, reflecting the timing of Social Security payments on a Friday as well as the end of some banks' Eurodollar arbitrage activities.

William C. Melton

Note: The full text of this letter is available to Telerate subscribers on pages 7250-51 on the Monday morning following the Friday date of the letter.

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Market Yields

	10/2/81 (Noon)	Week Ago	Year Ago
Prime Lending Rate at Irving Trust Company	19.50	19.50%	13.50
Effective since	9/22/81		
Discount Rate at Federal Reserve Bank	14.00	14.00	11.00
Federal Funds	17.25	14.00	13.50
Repurchase Agreements	16.25	13.50	12.50
U.S. Treasury Issues			
Bills			
3 months	15.26	15.10	11.80
6 months	16.10	15.74	12.10
1 year	16.45	16.08	12.15
Coupons			
2 years	16.40	16.20	11.72
4 years	16.05	16.00	11.65
7 years	15.85	15.70	11.58
10 years	15.55	15.45	11.52
Long Bond	14.95	14.87	11.45
Negotiable Certificates of Deposit-Secondary Market			
1 month	16.65	15.00	12.80
3 months	17.00	15.90	12.90
6 months	17.10	16.70	13.00
1 year	16.75	16.50	12.80
Banker's Acceptances			
1 month	16.50	15.00	12.75
3 months	16.55	16.00	12.90
6 months	17.00	16.75	12.95
Eurodollar Deposits			
1 month	16.88	16.13	13.25
2 months	17.19	16.50	13.44
3 months	17.75	17.13	13.50
Commercial Paper - Prime Names			
Directly placed by:			
Finance Companies			
1 week	16.25	12.00	11.00
1 month	15.50	14.25	12.25
3 months	14.75	14.25	11.75
Bank Holding Companies			
1 month	15.13	14.75	12.75
Dealer Placed:			
3 months	15.25	15.75	12.63
New AA Corporate Utility Bond	18.25	17.75	13.50
Tax Exempt			
6 month Project Notes	9.15	8.90	5.40
1 year AAA Bond	9.00	8.75	6.00
5 year AAA Bond	9.55	9.60	6.20
20 year AAA Bond	11.75	11.50	8.60

This information represents prevailing market yields.
It should not be construed as an offering.
All yields are on the offered side of the market.

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